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Beyond Budgeting - a high-hanging fruit

The impact of managers' mindset on the advantages of Beyond Budgeting

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Abstract

Beyond Budgeting is an alternative management control systems which evolved in the late 1990s. Even though the Beyond Budgeting system offers advantages to those organizations competing in the sector of knowledge industry, there are only few organizations practicing this approach today. This paper tries to give an answer to the question why Beyond Budgeting did not spread in the knowledge based modern industries and what might be impact factors regarding a successful approach. First this paper gives an overview of the development and the literature regarding beyond budgeting. After that the advantages of Beyond Budgeting are pointed out, especially in terms of organizational justice. We then show that the ability of managers and employees to participate in decision making and to accept a coaching management style might be a key factor for a successful approach. Moreover, this requirement might hinder organizations to start a Beyond Budgeting project as it would mean a change in mindset which is difficult to achieve. We suggest that Beyond Budgeting offers great benefits and advantages especially in terms of perceived organizational justice. But only those organizations which managers and employees are able to change and leave their comfort and turn into stretch zones, can harvest those advantages the Beyond Budgeting approach offers.

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1. The problem with budgetary control

For more than 15 years, the disadvantages which allow an allocation of resources by drawing up a plan are being intensively discussed in practice and science. This criticism mostly refers to the rigidity, great effort and the missing strategic orientation with regard to the distribution of the resources within a company: “The budget is the bane of corporate America” -Jack Welch, ex-CEO, General Electric- (Loeb, 1995).

Setting up a budget, in the sense of making a forecast how much to spend and trying not to overrun this goal, is a useful tool in societies and its organizations. And it has already been used by the first human civilizations to allocate rare resources like wheat (Solomons, 1952).

In extensions of the use of budgets, organizations started to use this simple and useful mechanism (budgets) not only as a planning tool but mainly to control and evaluate their employees (Johnson, 1978; Johnson and Kaplan, 1987; Quail, 1997). Budgeting in the sense of budgetary control, including control and evaluation systems based on forecast and fixed goals, became a powerful tool in organizations. Today budgetary control is the core of nearly every management control system used in organizations and most organizations are satisfied with their system (Libby and Lindsay, 2010). Even though budgetary control causes some dysfunctional effects in organizations, which might cause much more problems than it suggests to solve (Hope and Fraser, 2003a), very few organizations strive to change their system (Libby and Lindsay, 2010). Since the pioneering work of Argyris in the early 1950's scientist know about those dysfunctional effects caused by budgetary control (Argyris, 1953). One of the main problems Argyris found was that the hierarchical system of top-down budgeting, caused serious problems in human relations at work, especially when budgets were used as a top-down externally controlled pressure device. This pressure caused a lot of problems like budgetary slack, data manipulation or the refusal of cooperation between departments which compete against each other for rare resources (Argyris, 1953). So it is not surprising that scientist like McGregor called for a new way of controlling and evaluating employees and managers (McGregor, 1960). Even though a lot of scientist called for the usefulness of giving employees a voice in the process of budgeting (budgetary participation) (Hofstede, 1967; Milani, 1975; Merchant, 1985; Langevin and Mendoza, 2013) there did not seem to be much progress during the last 40 years (Libby and Lindsay, 2010; Umaphy, 1987). The refusal of changing the management control system for achieving a smarter and more efficient kind of control might cause much more problems in today's knowledge economy, as hierarchical control seems to stifle innovation which is the most important resource of knowledge economy (Marginson and Ogden, 2005a, 2005b; Bisbe and Otley, 2004).

2. The evolution of management control system

Already in 1998, the “Beyond Budgeting round table“, a cooperation between economy and science was founded to establish a new kind of resource distribution. The research directors and originators of the Beyond Budgeting concept, Jeremy Hope and Robin Fraser, published an extensive paper in 2003 in which they demonstrated a concept for the allocation of resources without strict plans (see table 1). The Beyond Budgeting is mostly composed of six principles and six methods which allow an allocation of resources in a highly dynamic economic context. Instead of planning, the focus is set on coordination with the help of internal markets (Hope and Fraser, 2003a, 2003b, 1997).

Table 1: Overview on Beyond Budgeting main thoughts in theoretical discussion

Author (chronologically)	Main thought
Argyris, 1953	Budgeting is a powerful tool but it causes some dysfunctional effects in organizations. No solution for that dilemma.
Fraser / Hope, 2003a	Allocation of resources works a lot better without planning. The radical prevention of budgets goes along with 6 leadership principles and 6 performance management principles that arrange for an optimal allocation of resources in a business.
Weber / Linder, 2008	There is generally always a trade-off between dynamic and complexity in all budgeting approaches. Beyond Budgeting allows the allocation of resources in a

	very dynamic context. In this respect, the illustration of a lot of details needs be disclaimed which goes along with a loss of complexity tolerance. Not every kind of complexity can be covered hereby.
Bogsnes, 2009	The implementation of Beyond Budgeting in practice shows that in order to work successfully with this model a radical change is needed in the minds of manager and staff. The conversion towards Beyond Budgeting means long lasting adjustments of management philosophy.
Hope / Bunce / Rössli, 2011	Advancement of the 12 principles and methods to 12 principles which create an adaptive management model. This new kind of planning and controlling enables a completely new management philosophy. Following the 12 principles a new integrated management approach has to be pursued which focuses less on control but more on self-control of operative units, focusing on employees potentials and sustainable value creation rather than on shareholder value and short time profits.
Bourmistrov / Kaarbøe, 2013	Implementing Beyond Budgeting and creating a new management control system including unbundling of the budgeting functions (forecasting, target setting & resource allocation) in combination with a dynamic and transparent process for resource allocation, leads to a positive change in the mindset and behavior of decision-makers.

Following the first publications of the Beyond Budgeting concept by Hope and Fraser, this concept was picked up in practice and science and remodeled several times depending on the problem statement. Bogsnes focuses on creating and supporting a new mind-set in management philosophy and empowering staff by going beyond budgets (Bogsnes, 2009). In this case the model was further adapted towards a management philosophy with regards towards the classical functions of controlling like planning, regulation and control. This advancement is also being promoted by Hope et al. (Hope et al., 2011). As Beyond Budgeting means great structural changes in leading, planning and controlling of staff and business this advancement towards an integrated management philosophy as described by Hope et al. seems reasonable (Hope et al., 2011). The strong relationship between management control system and management mindset and behavior is also shown by Bourmistrov and Kaarbøe (Bourmistrov and Kaarbøe, 2013). A basic understanding of Beyond Budgeting and the main differences of different kinds of budgeting shall be outlined. In table 2 the main differences of the today used budgeting models are displayed.

Table 2: Problem solution models in Budgeting theory

	Conventional Budgeting	Better Budgeting	Beyond Budgeting
Resource allocation	plans (budget)	plans (budget)	Internal market or self coordination under defined framework
Targets and performance measurement	absolute figures, internal orientation	relative figures, benchmark orientation	relative figures, benchmark orientation
Incentive System	coupling between budget achievement and incentives	uncoupling budget achievement and incentives	uncoupling budget achievement and incentives
Link to cooperate strategy	Non	existing- central	existing- decentral
External control	high level	low level	Non
Reference period of operational planning	3 years	1 year, continuing 1-2 years	no operational planning
Reference period of forecast	accounting year	rolling	rolling
Implementation effort	low level	medium level	very high level
System intention	allocation of resources	enhanced allocation of resources	adaptive management model
Managerial functions	permission, control, strategy	controlling in case of variations, strategy	consulting, support, guidelines
First goal of organization	maximize shareholder value	maximize shareholder value	raising employees potentials to convince costumers and create sustainable value

Weber and Linder determined in 2008 that especially the characteristic of the dynamic and complexity in the business environment and within the business itself is the crucial factor for the optimal form of budgeting. Beyond Budgeting has, according to Weber and Linder, great advantages in high dynamic conditions which are mainly generated by the fast distribution of resources with the help of internal markets. To estimate the chances of success and the risk of failure of a Beyond Budgeting implementation, dynamic and complexity are the basic impact factors in the current state of literature. A budgeting system needs to adapt to the degree of dynamic and complexity. There is always a tradeoff between the accomplishment of dynamic and the accomplishment of complexity within a budget system. So a budget system that copes well with dynamic needs to leave some details (complexity) behind (Weber and Linder, 2008). Figure 1 clarifies the tradeoff between dynamic and complexity and the degree to which the different budget systems can cope up to each dimension.

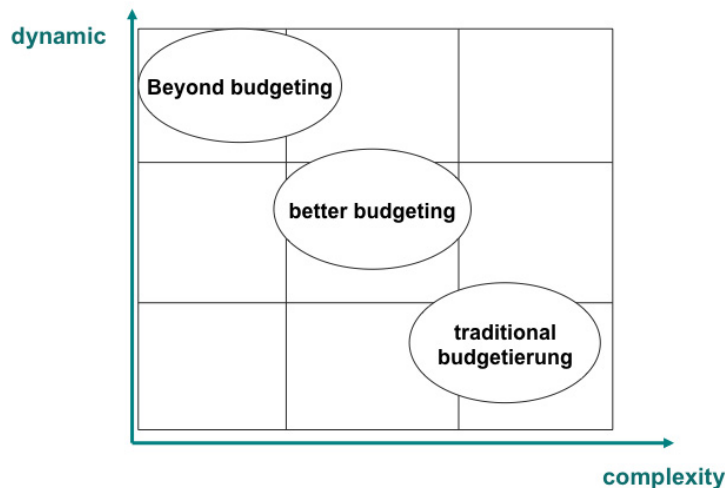


Figure 1: Suitability of budgeting models in different dynamic and complexity ranges

It seems that within the last ten years the environment of many businesses has become a lot more dynamic. If you keep in mind the increasing currency fluctuations, the fluctuations at the capital markets, the increasing inflation, the rapidly decreasing interest level and the high public debt of many states which very likely have an influence on the context of many businesses, it is astonishing that a model like Beyond Budgeting does not come out on top. Apparently the leadership and management philosophy in most businesses doesn't go well along with the openness and liberty in the principles of Beyond Budgeting (Bogsnes, 2009).

Dynamic and complexity as the only two impact factors to estimate the success or failure risks of a Beyond Budgeting implementation project is not sufficient. Especially the organizational frame and structure of businesses have to fit the ambitious requirements and principles of Beyond Budgeting. So it is essential to find out more about impact factors which might predict the success of a Beyond Budgeting application. Especially the loss of profound control towards more self-coordination and a new mindset in management philosophy might discourage top managers. Bourmistrov and Kaarbøe indicate that there might be a mutual relationship between management control systems in business organizations and societal mindsets, which is worth further consideration (Bourmistrov and Kaarbøe, 2013). This thought has also been focused on by Lingnau et al., who suggests that further impact factors might be found in the area of cultural imprint (Lingnau et al., 2004). Despite the fact that a management model like Beyond Budgeting relies on the cultural imprint of an organization, trust seems to be one of the most important requirements to put the Beyond Budgeting idea into practice. For example, a two-way communication, transparency and the sharing of knowledge is only possible if members of an organization can trust each other (Bogsnes, 2009; Rousseau et al., 1998; Colquitt et al., 2007). But as this free communication and the sharing of knowledge is

essential for both the Beyond Budgeting approach and the survival within an innovation driven economy, trust seems to be the missing link.

But how can organizations develop trust? And how can the management control system support this process?

3. Organizational justice and Trust

Despite the free flow of information, trust in organizations has various positive consequences e.g. on job performance (Colquitt et al., 2007; Rousseau et al., 1998). Trust is a dynamic construct that can build and also decline with an organization (Rousseau et al., 1998).

For building trust by a management control system, it is essential that the management control procedures (e.g. performance evaluation) and the enactment of those procedures by superiors are perceived to be fair (Wentzel, 2002; Maiga and Jacobs, 2007; Langevin and Mendoza, 2013). Fairness shall be defined as “the extent to which norms of propriety or entitlement are fulfilled” (Lind and Tyler, 1988, p. 3). In an organizational context the term “organizational justice” describes the extent to which employees perceive their employment relationship to be fair (Colquitt et al., 2005). All employees are subject to work related decisions every day. These decisions have a strong impact on employees’ economic and socioemotional situation and are therefore always regarded in a critical review. Most employees question if the decisions their superiors made were “fair” (Colquitt, 2001). Moreover, if a decision is based on fair procedures and a fair enactment of these procedures, employees are likely to accept this decision even if it has unfavorable outcomes for themselves. And favorable outcomes might get unaccepted because of a formation that is provoked to be unfair (Folger and Bies, Robert, J., 1989, Lind and Tyler, 1988, 1988).

Various empirical studies showed that, organizational justice has a strong and significant positive impact on employees’ trust in their superiors and on organizational trust (Cohen-Charash and Spector, 2001; DeConinck, 2010; Colquitt, 2001). And this relation does exist even in completely different cultural imprints (Li and Cropanzano, 2009).

The importance of fairness is especially true in a budgetary setting and the allocation of resources. Employees receiving more resources are only satisfied if the allocation process and its enactment had been fair and especially if they were able to participate in this process (Magner et al., 1995). Like shown above, dysfunctional actions appear because of the pressure and distrust within a company. Even though budgetary control is meant to replace trust through control, it has been shown that trust is much more efficient in maintaining organizational values and correct behavior (Boggsnes, 2009). By building trust through organizational justice, there is no need for budgetary gaming, data manipulation or other dysfunctional actions. Maiga and Jacobs found that a high occurrence of organizational justice leads to the building of trust which in turn reduces budgetary slack (Maiga and Jacobs, 2007).

The question is now, how can a management control system characteristic support this process?

4. Participation in the decision making process

Participation is defined as the degree to which an employee is allowed to voice his / her view in a decision making process (Milani, 1975). Already in the 1960’s Hofstede found that participation has the strongest effect on employee satisfaction of all variables he examined in his study (Hofstede, 1967). The direct negative impact of participation on the creation of budgetary slack have been attested by research as often as it has been refuted (Dunk and Nouri, 1998; Shields and Shields, 1998). However participation does have a strong and positive effect on organizational justice. Employees who are allowed to voice their opinion do have much higher perceptions of organizational justice than those ones getting their goals and resources in the form of a top-down unnegotiable budget. Employees perceiving high levels of organizational justice build trust which in turn leads to a reduction of budgetary slack. So effect of participation on the reduction of dysfunctional behaviors seems to be moderated by organizational justice. (Maiga and Jacobs, 2007; Staley and Magner, 2007). Participation seems to be an important key for the reduction of dysfunctional behaviors. But also managers’ ability to guide and support their employees in this participation process and giving inspiration by coaching seems to be essential for raising the level of perceived organizational justice (Cho and Dansereau, 2010; Gillet et al., 2013).

To sum up these findings, there seems to be some evidence that reducing dysfunctional effects can be reached by a management control system that is developed to be fair and transparent and that is executed by managers who

practice a leading style which can be characterized as “coaching” and allowing their employees to voice their opinion.

5. From comfort to stretch zones:

After identifying the advantages of Beyond Budgeting and offering more participation, we now take a closer look, to what might hinder managers to implement this system.

Budgetary control offers managers something that managers and human naturally lean toward to, the safety of comfort zones. One of the main problems of the classical system of budgetary control is that it establishes comfort zones, offering safety and convenience to managers (Bogsnes, 2009). Comfort zones are characterized by stability and routine regarding the requirements of managers and a stable environment in which problems can be solved by always the same approaches and procedures. So in comfort zones there is now need to stretch for approaches that are ambitious and challenge managers to stretch themselves. Comfort zones lead managers to refuse new business opportunities to minimize their risks (Bourmistrov and Kaarbøe, 2013). Beyond Budgeting moves managers from comfort to stretch zones. In stretch zones managers have to be ambitious, accept risks and deal with uncertainty, which is important when acting in a knowledge based business. However this change probably causes fear and refusal as it changes the requirements for managers and not all managers are able to fulfill this new requirements, like being challenged from supervisors and employees or delegate decisions and enable more participation (Bourmistrov and Kaarbøe, 2013; Bogsnes, 2009). So it is very difficult to realize the changes which are necessary for a successful Beyond Budgeting approach, because a lot of managers might refuse the required changes in mindset.

6. Conclusion

Overall a coaching management style provoking empowered and accountable employees is the core of the Beyond Budgeting approach (Bogsnes, 2009). So organizations working toward this approach might gain a much higher level of organizational justice including all the advantages described above. The ability of managers and employees to adapt this system of coaching and active participation in their daily work and move from comfort to stretch zones, might be the most important impact factor regarding the success of a Beyond Budgeting approach. We showed that implementing Beyond Budgeting might gain a lot of advantages especially for knowledge based organizations. But the system might be difficult to implement as it requires changes in managers and employees mindset. It seems that most organizations are not ready to stretch themselves yet. This might be a reason why Beyond Budgeting, a system offering real advantages and bringing more democracy to business organizations, is not attractive to organizations. Maybe it requires more disavowal in the markets to make managers move from comfort to stretch zones. However, this impact factor might be seldom in practice as it requires a change of managers and employees mindset which is difficult to achieve (Bourmistrov and Kaarbøe, 2013). But the advantages might be worth the effort but to harvest this fruits organizations have to stretch.

7. Further research

As participation and leadership style is just a small detail of a management control system further research on the effects of other management control system characteristics on organizational justice may enrich our knowledge about the impact of Beyond Budgeting ideas. We also need to learn more about the development and impact of comfort zones and the ways forward to stretch zones. Another interesting question is how the Beyond Budgeting systems might offer new ways in enabling higher levels of organizational justice.

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